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Book Review

Doron Kliger and Gregory Gurevich, *Event Studies for Financial Research: A Comprehensive Guide* (New York: Palgrave Macmillan, 2014). 189 pp., \$75, ISBN: 978-1-137-43538-5

The predictability of the returns of stocks and bonds in financial markets has captivated researchers for more than half a century. Numerous studies have used the Event Study Approach (ESA) to examine how prices move over time and how they are impacted by specific kinds of events. Kliger and Gurevich' book on this popular methodology delivers what it promises in its subtitle: a comprehensive guide.

According to believers in what is known as “the semistrong form” of the Efficient Market Hypothesis (EMH), security prices always reflect all publicly available information. If the EMH holds, the implication is that it is impossible to accurately predict abnormal returns on the basis of such information. Systematic violations of the EMH can potentially be attributed to “technical” market imperfections such as illiquidity, arbitrage costs and taxes, but they can also relate to the psychology of market participants. After more than five decades of research there appears to be a growing agreement among researchers that security prices are indeed highly correlated with intrinsic value but sometimes substantially diverge, and that it is possible to predict returns but not with high precision.

Direct tests of the EMH concentrate on the time it takes the market to react to information that has become publicly available. In an efficient market, full price-adjustment to information inherent in firm-specific and economy-wide events should be instantaneous. The ESA is well-suited for directly testing the EMH, as it assesses the impact of a particular type of event on the prices of securities.

After an introductory chapter, Chapter 2 of *Event Studies for Financial Research* focuses on the EMH. It explains the theory and rightfully positions the ESA as an effective tool for empirical tests. To illustrate the EMH and the role of the ESA this chapter also briefly reviews some classic event studies. Several boxes throughout this chapter connect theory with the reality of active investment management in modern times. Attention is paid to prominent individual investors who attempted to beat the market, and to Eugene Fama, one of the 2013 Nobel Prize winners in Economics and a founding father of both the EMH and the ESA.

Chapter 3 explains the basic technical aspects of the ESA. Of crucial importance is the specification of “normal” returns, or returns that would have been expected in the absence of the event of

interest. These benchmark returns are deducted from the actual returns to find the abnormal returns. The abnormal returns are then cross-sectionally combined in a test statistic to determine whether the event has a significant impact. The authors present several choices for modelling normal returns. Conclusions about abnormal return patterns are always conditional on the accuracy of the underlying normal returns – the notorious joint hypothesis problem in financial market research – and modelling the normal returns in alternative ways can show the sensitivity of the results to model specification. Even though simple return benchmarks are normally adequate for short-window event studies, Kliger and Gurevich also discuss Fama and French's three-factor model and Carhart's four-factor model. The last step of the basic ESA application is the cumulating of abnormal returns over consecutive days or periods of time, to reveal the possible impact of the event on the development of prices over a longer time frame. The authors conclude Chapter 3 with discussions of the interpretation of possible outcomes, the implications for the EMH, and the information value of the analysed event.

Chapter 4 illustrates the basics of the ESA step by step on the basis of a small and non-representative sample of four airline operators involved in air crashes. The simplicity of this example will be especially appealing to readers who are new to the ESA and have a limited mathematical background.

Chapter 5 elaborates on statistical tests of the null hypothesis of “no reaction” to the event of interest, and the conclusions that can be drawn from the results. Chapter 6 considers a variety of specific issues that are frequently encountered in practice and shows how these can be addressed. Examples relate to event clustering, and the sign and rank test as nonparametric alternative tests.

The final two chapters of the book contain the detailed descriptions and solutions of extensive hands-on exercises. Data and other files are provided via the book's website.

The authors do not purport to be exhaustive in terms of methodological details and refer to review papers for further technical discussions. One small but relevant issue that the authors may consider adding in an updated version of the book is the fact that stocks frequently feature substantial heteroscedasticity, that is, differences in volatility. The solution for heteroscedasticity is standardization, which, in essence, corresponds with applying weighted least squares.

To expand the target audience of the book, the authors could have added a chapter on the application of the ESA in securities litigation. Event study methodology is widely used to assess claims

of financial injury resulting from violations of securities laws, and both experts and lay people involved in such lawsuits may benefit from case studies and the discussion of related methodological and interpretation issues. Last, for the readership of the Journal of Behavioral and Experimental Economics it would have been interesting to see more specific applications of the ESA in behavioral finance research and reviews of psychological explanations for earlier evidence of EMH violations.

Kliger and Gurevich deserve credit for this thorough and comprehensive event study manual. It is written in an accessible manner, and provides a wealth of context to methodological aspects that would otherwise be dry and harder to understand.

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